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ORR STAKEHOLDER ACCESS PRICING WORKSHOPS

WORKSHOP FINDINGS

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Contents

Introduction

Context and purpose of the workshops

In its PR23 Final Determination, the Office of Road and Rail (ORR) committed to work with stakeholders of the GB rail network in advance of the next periodic review to (i) better understand issues that were raised with the access charging regime for Network Rail's infrastructure during the PR23 process and (ii) support developing solutions.

To begin this process of working with stakeholders, the ORR invited passenger and freight stakeholders to workshops in early September 2024.[1] The purpose of these workshops was to gather stakeholders' views on issues with the access charging regime and potential solutions to those issues. The findings from these workshops will inform the ORR's planned consultation in early 2025 on potential changes to the approach to calculating access charges, ahead of the launch of PR28 in 2026.

The reform of the rail sector in Great Britain will bring track and train services together under Great British Railways (GBR). Therefore, existing commercial relationships between funders, Network Rail and train operators (passenger, both open access and government contracted services, and freight) will change to reflect this new industry structure. The future legislative framework which will govern these relationships remains to be seen and the workshops recognised that change was expected, but proceeded on the assumptions that: 1) there would continue to be periodic reviews of Network Rail (or the infrastructure arm of GBR); 2) that there will be train operators outside of GBR; and 3) that there will be a new legal framework which ensures that the infrastructure arm of GBR charges operators for use of its network, according to a charging framework set by ORR.

Frontier Economics Ltd (Frontier Economics) assisted the ORR with workshop facilitation and has produced this note of the workshops. **Please note that the ideas and opinions captured in this document reflect the views of attendees of the workshops; they do not necessarily represent the views of either the ORR or Frontier Economics.**

Workshop set-up

The workshop attendees were sent a pack of materials to read ahead of the workshops. This pack included a document outlining the current charging regime and slides covering background material and questions on: a draft set of objectives for a rail charging regime for the next price control period (Control Period 8 - CP8); the proposed scope of the ORR's review; and deeper dives on the Variable Usage Charge (VUC) and Infrastructure Cost Charges (ICC). These topics had been identified by the ORR as key areas for the review of how charges are calculated within the access charges framework, although the precise scope of the review is

1 Passenger operators were invited to a 3 hour online workshop on 9th September 2024. Freight operators were invited to a 3 hour online workshop on 10th September 2024. A session for Charter operators will be held on 1st October 2024.

not yet determined and was a topic for discussion at the workshops. Attendees were also invited to read the report *Options for Changes to the Access Pricing Regime*, published by the ORR in August 2024.

In addition to passenger and freight stakeholders, there were attendees at the workshop from the ORR, Frontier Economics, Network Rail, and Transport Scotland. Network Rail presented on its planned work on simplifying the price list for the VUC.

Key themes

This section presents the key themes that emerged from the discussions in the two workshops. The themes are structured in six categories:

- Stakeholder hopes and expectations from rail reform;
- The objectives of the charging regime;
- The ORR's proposed scope for the access pricing review;
- The proposed review of the Variable Usage Charge (VUC);
- The proposed review of the Infrastructure Cost Charge (ICC); and
- Additional scope suggestions.

Not every point made in each workshop is captured in this section, as this section identifies the key themes that emerged from the discussions across both workshops, on topics related to the categories above.

Hopes and expectations from rail reform

Attendees of both workshops highlighted that the scope of rail reform will have an impact on the focus areas of the ORR's review of the access charging regime. In particular, attendees said that the timing of the Department for Transport (DfT)'s consultation on rail reform will be an important milestone for the ORR to then define the most appropriate subjects of the access pricing regime's review.

In addition to comments on the timing of the ORR's review, participants made four key observations regarding the scope of rail reform, in terms of its connection to, and potential impact on, the access charging regime:

i. The potential for rail reform to change the legislation underlying the access pricing regime, and in doing so permit a different set of objectives for the regime (or weighting across a set of objectives). These objectives could be environmental or safety improvements, or be connected to policy objectives regarding network use.[2]

ii. The need for rail reform to be cognisant that the balance between taxpayer and user funding of the network will have a subsequent effect on the structure and levels of access prices.

iii. The potential for rail reform to take a broader view of impacts of different types of traffic across the whole network, rather than just the costs incurred by Network

[2] For example, the regime might look to reward the use of new technologies for avoiding derailment, take into account the competitive landscape for rail by factoring in the cost of road haulage, or look to support policies around the growth of rail freight.

Rail, for example, the impacts of running faster freight services increasing network capacity.

iv. The relevance and proportionality of the charging regime, should rail reform render access prices irrelevant to the majority of operators on the network (GBR operators). Should this be the case, attendees expressed a hope that the regime might be simplified, and also that the regime would ensure fair and transparent charges for those operators not within GBR.

Objectives of the charging regime

Attendees at both workshops were presented with the ORR's potential CP8 charging framework objectives:[3] incentivising performance and efficient use of the network; supporting asset and financial sustainability; ensuring practicability and simplification; and achieving transparency and predictability.

Attendees were largely in agreement with these objectives as being suitable objectives for the charging framework. The following views were also shared:

- The regime should be cognisant of the wider context for operators and be aligned with policy objectives.[4] In particular, the regime should (i) give operators the incentive to decarbonise, for example through the introduction of electric locomotives, (ii) further policy objectives of increasing rail freight volumes, and (iii) consider the whole industry impacts, not only Network Rail's costs.
- The regime should promote use of the network by both operators and Network Rail to align with the ORR's Section 4 duties.[5]
- Any reduction in complexity and increase in predictability should facilitate new business opportunities and investment decisions by operators, as well as reducing uncertainty and administration costs for business as usual processes (BAU) where possible.
- The regime should create access charges that are compatible with industry systems, particularly billing systems.

Attendees at both the passenger and freight workshops expressed a hope that any changes to the access pricing regime would nonetheless preserve what is good about the current regime: in particular retaining the fair and non-discriminatory treatment of different operators.

3 These have not been agreed and were presented by the ORR to inform discussion. The ORR will confirm these to the industry in due course.

4 We note the clear connection and overlap between this objective for the regime, and the hopes and expectations of the attendees regarding rail reform.

5 See paragraph 3 of Section 4 of the Railways Act, https://www.legislation.gov.uk/ukpga/1993/43/section/4.

Scope of the ORR's review

The ORR shared a draft list of focus areas ahead of PR28 for discussion. For the VUC, this comprises looking at the capping policy for freight and charter operators, reducing complexity of the calculation of the VUC, investigating the incentive properties of the VUC and considering price list simplification (both calculation and presentation). For ICC, this comprises reviewing the market can bear methodology and market segmentation, looking at current exemptions and phasing in profiles, and investigating what level of cost the ICCs should recover.

Attendees made the overall point that the scope of the review ought to remain flexible until the details of rail reform are known in more detail.

Additional topics proposed for review were: EC4T (in particular, the wash-up mechanism), and station charges (if this is relevant once rail reform details are clearer). FTAC was considered important for review by some passenger stakeholders, but not relevant by others. Some attendees noted that FTAC is determined based on the level of the Network Grant provided by the DfT to Network Rail and so could not be reviewed by the ORR in the same way as other charges.

Variable Usage Charge (VUC)

The ORR presented the proposed overall objective of the VUC review as to improve the robustness and the transparency of cost modelling. More specifically: reviewing the cost base and robustness of modelling; and simplifying the price list.

The discussion around these proposals, and wider thoughts from the attendees of each workshop on VUC, highlighted the following key themes:

- **Levels of VUC** The existing level of VUC was highlighted as problematic by the freight operators: (uncapped) rates were considered to be unaffordable. Stakeholders noted that Network Rail's cost base had increased with every control period, resulting in increased charges for operators using the rail network; this was contrasted to what was described as a comparatively stable cost base (and hence operator charges) to transport freight by road. Stakeholders therefore consider the level of VUC as a risk to the commercial viability of freight rail.
- **Predictability of VUC** Freight operators stated that the cycle of caps, the unwinding of these caps, and then their re-introduction in the face of Network Rail's increasing cost base each control period resulted in the VUC being difficult to predict over the longer term (i.e. beyond the control period), resulting in increased uncertainty and making their businesses harder to plan.
- **Incentive properties of VUC** There was broad agreement among workshop participants that the incentive properties of the VUC are limited, with the exception of some marginal price effects for optimising some (limited) choices on the network. The overall consensus was that VUC did not incentivise environmental, safety or efficiency

related behaviours, given the wide range of other factors influencing where and how operators run assets on the network. Additionally, stakeholders considered that the levels of VUC were too low to drive meaningful decisions when purchasing new rolling stock because of the relatively small proportion of total costs that the VUC makes up.

- **Transparency of VUC** Stakeholders expressed frustrations related to a perceived lack of clarity in terms of the actual costs going into the VUC model. Some operators queried whether the levels of VUC are linked to actual costs incurred by Network Rail, or even if they are, suggested that those costs may not be at an efficient level. Other stakeholders expressed frustrations regarding the lack of transparency of how costs are allocated between different users, particularly which costs are incurred by Freight Operating Companies (FOCs), and which by passenger Train Operating Companies (TOCs), and expressed a desire for greater clarity and transparency in this regard.
  - Some operators therefore would welcome the opportunity to scrutinise the Network Rail model inputs and outputs in greater detail.
  - More generally, some operators expressed a desire to be offered greater levels of understanding of where the numbers come from in the VUC calculator, and to have help to understand the movements in prices over time.
- **Complexity of VUC**
  - The VUC was broadly accepted by attendees as *necessarily* complex, and that managing that complexity is doable in steady-state operations.
  - Those who work with VUC tend to understand it, despite its complexity, although there was a view that people who did not work so closely with the system (such as senior managers and freight customers) did not understand the VUC. It would, therefore, be useful for Network Rail to provide more transparency and explanation of the model so that it can be more widely understood, in particular to address questions related to which costs are fed into the model and how these are allocated across different users.
  - The complexity of the VUC becomes more problematic when operators are looking to make changes which are outside the existing evidence, for example: freight operators taking on new customers and using a new wagon/commodity combination; or freight and passenger operators looking to introduce new rolling stock. The process of agreeing a VUC in these circumstances takes a long time (sometimes several years) and is laborious – requiring detailed engineering input from rolling stock manufacturers. Connected to this point, stakeholders suggested that some legacy prices that are no longer relevant for operators are included in the price list and these should be removed. A related issue raised by several stakeholders is the difficulty of making links between the VUC calculator and industry billing systems; this could be improved to ease the process of introducing new rolling stock. Network Rail noted that it has recently changed its process for approving new VUC rates for new types of rolling stock through a Track Access Panel and hopes that this will simplify and accelerate this process.

- Some stakeholders suggested that if the data used to calculate the VUC is readily available, it may as well be used; a Network Rail representative suggested that the data is used to plan maintenance and renewal activity and that no data is created solely for the purpose of administering the VUC.
- Some freight operators were supportive of a banded VUC (assuming transparency in advance of how that would work for the operators) as this may simplify the calculation of the VUC for freight.

Some attendees of the workshops highlighted that there were alternative options for how the VUC was calculated: for example, moving to marginal cost from average direct cost, as a more radical change of the VUC in terms of how direct costs are identified. Another suggestion for a more radical simplification of the VUC from the passenger operator workshop was to consider a per-unit basis for the VUC.

Infrastructure Cost Charge (ICC)

Passenger workshop attendees were invited to consider the ORR's market can bear methodology, the market segments currently in use, the exemption for pre PR18 Open Access Operators (OAOs), the phasing in profile and the total level of ICC income relative to avoidable fixed costs. Freight workshop attendees were invited to consider the difference in information used to calculate ability to pay for freight operators relative to passengers, a proposal that would introduce distance banding for market segmentation and any other ideas.

In terms of the ICC charge generally:

- **ICC consistency** The workshops included a discussion around the importance of regulatory consistency and predictability. Attendees stated that it is important for the ORR to maintain consistency over time to facilitate business planning, but that the regulatory approach to ICCs must nevertheless keep pace with market forces and be aligned with wider legislative requirements such as the Competition Act. Overall, passenger OAOs described this as an issue of "regulatory fairness". They expressed a view that the ORR should set the regulatory "rules of the game" such that the operators are held neutral to changes in their business environment introduced by the ORR, such as changes to the level or extent of ICCs.
- **ICC proportionality** The freight attendees suggested that the lost traffic as a result of the ICC charges, together with the regulatory burden to monitor and impose these charges, outweigh the benefit of the limited revenue that these charges raise for Network Rail. A related point was that levying this mark-up at all is working directly against the growth targets for rail freight. In addition, the 10% threshold of traffic loss as a result of a mark-up was considered by some stakeholders to be arbitrary and not consistent with the policy desire to increase the volumes of rail freight using the network; and therefore may not be the appropriate.

There were a couple of points that were raised on the specific segmentation approaches that workshop attendees felt could be appropriate moving forward:

- Passenger operators suggested that segmenting by geography, and specifically London vs non-London flows, could be appropriate. This was connected to a point that both the levels of these charges and the phasing in of these charges, should be different for these two types of flows. Specifically, 4 year phasing in with higher ICC levels could be suitable for London flows, whereas 5 year phasing in with relatively ICC lower levels would be suitable for non-London flows.
- Freight operator views on the idea of segmenting on the basis of distance were mixed. Some commodities might be suited to this approach but there were some concerns that the effect might be unhelpful distortions in customer behaviours, and more generally additional complexity to this block of the pricing regime.

Additional topics scope

EC4T was suggested as another area for inclusion in the review scope. The charge is unpredictable because it is a cost that is fully passed-on, and hence follows electricity prices which are volatile. Workshop attendees felt that the wash-up mechanism in particular is complex to calculate and operators are unable to predict each year whether they will be in credit or debit – and to what level – when the wash up is calculated. Relative to diesel, this is much more complex and unpredictable as an energy cost which acts as a disincentive to move to electric traction.

Station charges were also raised as an area for potential inclusion in the review, although this was considered to be dependent on the details of rail reform and too early to consider in detail now. However, it was noted that open access passenger and charter operators will continue to need to pay for station access and will want these station charges to be fair, reasonable and non-discriminatory.

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